Target Search in the Chinese Chemical Industry

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With the ever-increasing importance of the Chinese market, there is an obvious strong interest of foreign chemical companies to buy local players. As a consequence, China leads chemical M&A activity in the BRIC countries, accounting for two-thirds of deal volume in the first quarter of 2013, with six transactions worth more than US$50 million.

This is despite the many obstacles for acquisitions in China. Good target companies are hard to find, and the majority of deals are initiated by proprietary networks and brokers. The success rate for closing deals is much lower than in Western markets.

However, strategic investors – that is, companies already active in the chemical industry as opposed to equity investors – have a variety of god reasons to acquire chemical businesses in China. Buying a Chinese company may give an MNC access to local production facilities as well as to local key accounts. In addition, Chinese companies often have a low-cost distribution network, which is particularly important for mid-market products, where distribution has a higher share of the total costs. Such an acquisition may also allow execution of a two-brand strategy, such as done by DSM in their acquisition of ICD, a domestic producer of UHMWPE. It helped DSM to fill some portfolio gaps and to add different price segments. By taking over existing facilities as well as customers, growth via acquisitions can be much faster than when done organically.

Overall, most of the recent acquisitions of Chinese chemical companies by MNCs were in the core area of the MNC. Acquirers tend to be global leading players in the respective areas, for example W.R. Grace, which in 2012 acquired the Chinese Nobelstar Catalysts, expanding their production footprint in fluid cracking catalysts, or CABB obtaining local production capacity through the acquisition (via JV) of monochloroacetic acid producer Jinwei Huasheng. The overriding aim is to strengthen the local market position, add local production capacity and to target lower-end markets. In contrast, chemical acquisitions by MNCs are rarely used to enter completely new markets, or markets with weak starting position. For example, before AkzoNobel bought Boxing Oleochemicals, it was already a leading player in specialty surfactants.

Once the decision to search for an M&A target has been made, the selection criteria need to be defined based on the company strategy. This will result in a variety of criteria that may include, e.g.,

* Chemical sub-segment (as mentioned above, likely to be one in which the acquirer is already active – few Chinese chemical companies are technologically attractive as stand-alone targets)
* Customer base (in particular regarding overlap/synergies with existing customers of the MNC – for example, AkzoNobel acquired Prime Automotive Coatings as this domestic company served a lower market segment than AkzoNobel itself)
* Annual sales of the target (too large targets are not realistic while too small targets may not be worth the effort, often resulting in a target sales range, e.g., US$10-100 million)
* Profitability (particularly relevant if acquiring company is margin driven)
* Regional focus (e.g., a foreign company may want to strengthen its business in the West of China)
* Ownership type (private companies are more likely to be successfully acquired than state-owned ones)

* Company image and culture (as this will influence the later ease of integration)

Once at least a few basic criteria have been determined, one of the most difficult tasks in the whole process is the preparation of high quality long lists of targets. China's chemical markets are notoriously fragmented and fast moving – the market participants change rapidly, and it is not easy to get reliable data. The best approach is not to rely on a single database but utilize a variety of sources, e.g., databases from different providers, sourcing sites, market studies, expert interviews etc. Hints from the own sales staff may highlight some particularly promising targets. On the other hand, the resulting long lists will contain a large number of companies that are either only traders of the relevant chemicals or may not even exist at all (not such a rare occurrence either).

The subsequent elimination process should first focus on those criteria that are an absolute "must" and at the same time fairly easy to assess. For example, product groups or annual sales of a domestic chemical company tend to be easier to evaluate than the potential fit with the culture of a Western company. In the later stages (once only a handful of target candidates remain), more specific checks are vital, e.g.,

* Site visits
* In-depth analysis of products (e.g., quality, portfolio)
* Talks with customers
* Factual checks of company data.

For example, for a specialty chemicals company we looked at about 2100 companies in a specific chemical segment. Elimination of importers and traders brought the number down to about 700, which based on more specific criteria (particularly minimum sales size) could be reduced to about 50. Only at this stage some of the criteria that are more difficult to assess (e.g., technology level, potential willingness to do a deal) were taken into account. The top ten targets were then prioritized with the management of our client, leading to a detailed profiling of initially five companies.

Finally, a word of warning based on our past project experience. It is unlikely such a search will result in finding the perfect acquisition target. Often at least one aspect of the target will be less than ideal. In particular, few Chinese chemical companies can be integrated without major investment in HSE equipment. Only very few targets will be attractive from a technology standpoint - and if so, they are likely to be part of larger, less attractive operations. So a certain readiness for compromise is almost a precondition for an acquisition to eventually happen.